

Supreme Court, U. S.
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In The
Supreme Court of the United States

October Term, 1978

No. **78 - 394**

ANGELO COSTANZO,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE SECOND CIRCUIT**

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PRELIMINARY STATEMENT

Petitioner is a 65 year old baker who, during the indictment years, was president and majority shareholder of Costanzo's Bread, Inc. His wife, Josephine Costanzo, was treasurer and a minority shareholder in that corporation during those same years. Both were indicted on four counts of evading personal income tax in an amount of \$106,679.93 and four counts of evading corporate income tax in an amount of \$114,621.11. They were jointly tried before a jury under a net worth theory of prosecution. On September 1, 1977, Angelo Costanzo was convicted of the eight counts alleged against him. His wife was acquitted of the eight counts alleged against her.

On July 11, 1978, the U.S. Court of Appeals for the Second Circuit affirmed the conviction of Mr. Costanzo.

Under the facts of the case, the income attributed by the Government's theory to both Mr. Costanzo and to Costanzo's Bread, Inc. was comprised of essentially the same money. The Government claimed Costanzo's Bread, Inc. was the likely source of this money. The trial court limited cross-examination into the thoroughness of the Government's net worth reconstruction of the income ascribed to Costanzo's Bread, Inc. and to Mr. Costanzo by holding that the "efficiency" of the bakery business was not in question.

The Court of Appeals held that, since the Government negated all possible sources of non-taxable income, proof that Costanzo's Bread, Inc. was the "likely source" was unnecessary.

It is petitioner's primary contention that when the same money is ascribed to a corporation and then to an individual as income, the Government is obligated to show that the corporation itself received that income and was the source of that income to the individual. Suggesting that such proof is unnecessary implies that the Government may obtain a conviction without proving beyond a reasonable doubt that the corporation

received the income upon which both corporate and personal income tax were allegedly evaded.

Petitioner contends as well that when the Government elected to prosecute petitioner for tax evasion, particularly under a net worth theory, it had a duty to investigate the validity of the inferences which it would ask the jury to draw from the circumstantial evidence it would present to them. It is typical of income tax evasion cases in general and net worth prosecutions in particular that they depend heavily upon circumstantial evidence. Sophisticated investigative techniques are aimed at securing such circumstantial evidence, often through interaction with the taxpayer. Yet, it is the perilous nature of circumstantial evidence that it proves by inference rather than directly. Because of this, the Supreme Court has imposed upon the Government in its use of such evidence a duty to seek justice rather than a conviction. Accordingly, petitioner contends that when the Government offers circumstantial evidence from which the jury is to infer a taxpayer's guilt it has the duty to reasonably attempt investigation of whether that inference is valid.

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**In The
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No.

ANGELO COSTANZO,

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**PETITION FOR A WRIT OF CERTIORARI
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Petitioner, ANGELO COSTANZO, prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered on July 11, 1978.

Opinion Below

The opinion of the Court of Appeals dated July 11, 1978, has not yet been reported. It is reprinted in its slip form in Appendix A, *infra*, at p. A-1 *et seq.*

Jurisdiction

Following a jury trial, petitioner was found guilty in the United States District Court for the Western District of New York for evading personal income tax in the amount of

\$106,679.93 during the years 1968-1971 (inclusive) and corporate income taxes in the amount of \$114,621.11 for those same years, all in violation of Title 26, United States Code, Section 7201. On January 11, 1978, the petitioner was sentenced to four concurrent one year and one day terms in prison for evading personal income tax during each of the indictment years, and four \$10,000.00 fines for evading corporate income tax during those same years.

Petitioner appealed his convictions to the United States Court of Appeals for the Second Circuit. On July 11, 1978, that court affirmed appellant's conviction.

On August 3, 1978, within thirty (30) days of the entry of that decision, Mr. Justice Thurgood Marshall signed an order granting petitioner an extension of time through September 8, 1978, to file his petition for writ of certiorari. This petition is filed within that time limit. The jurisdiction of this Court is invoked under 28 USC 1254(1).

Constitutional Provisions Involved

Constitution: Art. 1, Sect. 9, Clause 4.

Capitation and other direct taxes

No Capitation or other direct tax shall be laid, unless in proportion to the Census or Enumeration herein before directed to be taken.

AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; not shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be

deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation.

AMENDMENT VI

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defense.

AMENDMENT XIV

Because of its length, it is reprinted in Appendix B, *infra*, at p. B-1 *et seq.*

Statute Involved

26 U.S.C. §7201 Attempt to evade or defeat tax

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000.00 or imprisoned not more than 5 years, or both, together with the costs of prosecution.

Questions Presented

1. Can the Second Circuit fashion a new rule which allows the Government to prosecute and convict a taxpayer for evading corporate and personal income tax without the burden or responsibility of showing that the corporation had income and that such corporate income became the taxpayer's personal income?

2. Can the Government discharge its duty to see that justice is done where it could have but failed to investigate the inferences it asked the jury to draw from circumstantial evidence?

Statement of Facts

Angelo Costanzo was the eldest of a family of eleven children raised during the 1920's in the Italian immigrant section of Buffalo, New York. He began working part-time when he was eight years old. With the onset of the Depression in 1929, he had to quit school to increase his contribution to the family's support. But there were no jobs available. Therefore, at the age of 16, with very little money and less choice, he attempted to take over a failing neighborhood bakery business. He ran it singlehandedly from oven to peddling bread house-to-house, 13-16 hours a day, 7 days a week, without respite. His industry and reliability prevailed and gradually his business grew. By the 1940's he had four bakery shops.

In 1962, he founded and became president of Costanzo's Bread, Inc. He owned 90% of the shares of the corporation, his wife owned 5%, and the remainder were unissued.

On November 12, 1975, he and his wife were charged by the Federal Grand Jury in the Western District of New York, under Indictment No. 75-253, with eight counts of income tax evasion during the years 1968 through 1971. Counts I through IV charged an understatement of personal income by \$206,721.22 and the evasion of \$106,679.93 in additional taxes. Counts V through VIII charged an understatement of corporate revenues by \$242,070.92 and the evasion of \$114,621.11 in additional corporate taxes. The government's basic premise was that during the indictment years, the Costanzos took money from the business without declaring it as corporate income or personal income.

After a jury trial, Mrs. Costanzo was acquitted of all eight counts and Mr. Costanzo was found guilty on all eight counts.

The Government's case was founded upon a net worth theory of prosecution. The Government produced witnesses and exhibits for the purpose of showing that Petitioner's assets increased during the indictment years and that the increase was attributable to taxable income earned but not reported during that time.

The primary avenue of proof led through a maze of stock acquisitions which, according to the Government's theory, were purchased with unreported income. The total stock involved was not only the stock registered in the name of Petitioner and his wife, but also all the stock registered to their two sons, Angelo, Jr. and Richard. Internal Revenue Agents sought to establish that the stocks were actually purchased by the petitioner, and they included the purchase price of all the stocks in their computation of Mr. Costanzo's net worth.

As part of its burden of proof, the Government was required to demonstrate that the amounts expended during the indictment years were actually attributable to income received during those years. Petitioner asserted that since the Depression he had gradually built up a large cash reserve in safe deposit boxes and that this reserve was the source of the money for the stock acquisitions.

The Government gave limited credence to the Petitioner's assertions about the existence of a cash reserve and it credited the Petitioner with the amount of \$49,000.00 in cash as of January 1, 1960. That amount purportedly represented the contents of the one safe deposit box in Petitioner's own name on that date. This amount was based upon a Government experiment which showed that a maximum of \$49,000.00 in \$20.00 bills could be "stuffed" into the box. Mrs. Costanzo had two other safe deposit boxes as of January 1, 1960; however,

no credit was allowed by the Government with respect to those boxes. The Government ignored Mrs. Costanzo's safe deposit boxes as a non-taxable source of funds because she had told IRS agents that prior to 1960 all she received from Mr. Costanzo was household money.

In the trial, the defense contested the Government's conclusions as to the claimed taxable increases in net worth on several significant levels.

It contended that the increases in net worth were not attributable to income earned during the indictment period; that the Petitioner had not bought all of the stocks in the hands of his sons which the Government had attributed to him; and that the business was incapable of generating sufficient amounts of money to be the "likely source" for the alleged increases in net worth.

Although the Government tried to prove and claimed to have presented sufficient trial evidence that Costanzo's Bread, Inc. was the likely source of taxable income, the Second Circuit Court of Appeals held that:

"given the Government's proof of unreported income and its negation of all possible sources of non-taxable income, proof of a likely source of taxable income was not necessary."

Mr. Costanzo's conviction for evasion of both corporate income tax and personal income tax was thereupon affirmed.

REASONS FOR GRANTING THE WRIT

I.

Can the Second Circuit fashion a new rule which allows the Government to prosecute and convict a taxpayer for evading corporate and personal income tax without the burden or responsibility of showing that the corporation had income and that such corporate income became the taxpayer's personal income?

The basic premises of net worth prosecution were set forth by this Court in Holland:

Increases in a taxpayer's assets derive from taxable sources. *Holland v. U.S.*, 348 U.S. 121, 131 (1954).

and Massei:

Increases in a taxpayer's assets do not derive from nontaxable sources. *U.S. V Massei*, 355 U.S. 595, 595 (1958).

In *United States v. Costanzo*, the skeletal theory of the Government's case was straightforward:

1. Mr. Costanzo had substantial taxable income during the indictment years which he did not declare on his personal tax returns (basic evidence: assets in names of Mr. & Mrs. Costanzo and their two sons).

2. Mr. Costanzo got the money to purchase those assets from corporate income which was not declared on the corporation's income tax returns.

Fitting this theory into the format of Massei does not work. Negating nontaxable sources of the money which purportedly was used to purchase the assets does not prove that the money was income to the corporation.

Yet the Holland method of proof is not wholly satisfactory either. Holland might be adequate if it were only a matter of

showing that the corporation was the likely source of the money which was used to purchase the assets. But the Government set out to prove as well that corporate income taxes were also evaded on that money. The fundamental operating premise of both Holland and Massei is that the receipt of taxable income is reflected by an increase in assets. However, it was an increase in Mr. Costanzo's assets, not the corporation's, which the Government's case sets forth. Attributing an increase in Mr. Costanzo's personal assets to corporate income tax evasion in such a factual setting can only be accomplished by proving beyond a reasonable doubt that the corporation was the *specific* source of the money which was used to purchase those personal assets.

In other words, for Mr. Costanzo to have evaded corporate income tax, the corporation had to have realized the income alleged. For that corporate income to have been the same money which purchased the personal assets representing Mr. Costanzo's increase in net worth, the corporation had to be the specific source of that money/income to Mr. Costanzo as well. This is the only logical manner in which the separate convictions for evasion of corporate income tax and personal income tax can be reconciled under the requirements of due process.

It is a basic due process requirement that "proof of a criminal charge beyond a reasonable doubt is constitutionally required." *In re Winship*, 397 U.S. 358 (1970). As set forth above, the United States Court of Appeals for the Second Circuit held, *inter alia*, that:

"given the Government's proof of unreported income and its negation of all possible sources of non-taxable income, proof of a likely source of taxable income was not necessary" *U.S. v. Costanzo*, CA2, July 11, 1978, ____ F2d ____; Appendix P. A-12.

The Second Circuit affirmed the petitioner's conviction under a net worth theory of prosecution on four counts of evading personal income tax and four separate counts of evading corporate income tax on the same money. Yet if proof that the

corporation was a likely source is not necessary, how can it be said at all that the corporation received the income alleged?

"It is necessary for the Government to prove in a case such as this [wilful tax evasion] that a tax is due. *U.S. v. Moody*, 339 F 2d 161, 162 (6th Cir. 1964)"

For example, in *U.S. v. Goldberg*, 330 F 2d 30 (3rd Cir. 1964) cert. den. 377 U.S. 953, Goldberg was convicted under 26 U.S.C. 7201 of evading both personal and corporate income tax on the same money. On appeal, Goldberg contended the money was either income to him or to the corporation, but not both. The Court of Appeals held that individual liability was not repugnant to corporate liability because the government demonstrated that income was received by the corporation before it was received by Goldberg. That demonstration effectively destroyed Goldberg's contention. Although Goldberg was not a net worth prosecution, the distinctions relied on by the Court to rebut the appellant Goldberg's contentions illustrate the parameters of proof required to convict for evasion of both corporate and personal taxes.

As precedent, the Second Circuit's decision herein substantially affects tax evasion prosecutions in general. The clear implication of the decision below is that a taxpayer can be convicted of evading corporate and personal income taxes on the same money without showing that the corporation ever had that money as income and without showing that the taxpayer ever received it from the corporation. In reaching its decision, the Second Circuit sidestepped the fact that net worth does not refer to an increase in assets alone (*Holland, supra* 348 U.S. at 136) but rather is a technique for reconstructing income (*Merrit v U.S.*, 327 F2d 820, 821 [5th Cir. 1964]). It also overlooked the particularly significant interlocking nature of the corporate and personal incomes alleged herein which necessitated that the Government reconstruct corporate income to show that the corporation was not just a "likely" source but was the *specific* source of reconstructed personal income.

It is against such a backdrop that this court is asked to review the Second Circuit's decision upholding the net worth prosecution and subsequent convictions of petitioner herein.

II.

Can the Government discharge its duty to see that justice is done where it could have but failed to investigate the inferences it asks the jury to draw from circumstantial evidence?

This Court, in its review of the net worth method in *Holland*, took elaborate precautions to recite the grave dangers inherent in circumstantial evidence as used in net worth prosecutions. The Court pointed out specifically that the Government's duty is not to seek a conviction but rather to see that justice is done. *Holland v. U.S.*, supra, 348 U.S. at 135. This duty on the part of the Government to act in good faith to seek justice rather than conviction is a central characteristic of the American Legal system (for example, *Brady v. Maryland*, 373 US 83 (1963)).

As illustrative of the obligations which fall within this duty, the Holland court charged the Government with the responsibility of pursuing all relevant and reasonable leads put forth by the taxpayer in explanation of the increase in assets alleged to represent unreported taxable income. *Holland*, supra, 348 U.S. at 135. Petitioner contends that the Government's duty to seek justice requires as well that the Government act in good faith to check the validity of the inferences which it asks the jury to draw from the circumstantial evidence which it presents to them.

In the instant matter, the Court of Appeals held that "[t]he circumstantial nature of the proof relied upon in a net worth tax evasion case led the Supreme Court to indicate that the sufficiency of the evidence to support a conviction should be measured in light of the thoroughness of the Government's investigation of all relevant circumstances." (Part III of affirming decision, P. A-10). Yet in Part IV (p. A-12) of that

decision, the Court held that defense cross-examination of the Government's witnesses with respect to the gross profit percentage of Costanzo's Bread, Inc. went beyond the scope of direct examination and was within the trial court's discretion to exclude. The trial court, in foreclosing that cross-examination, stated:

"We are not here to test the efficiency of the operation" (Record on Appeal, 91).

The lower Courts ignored the fact so aptly expressed in *U.S. v. Moody*, 339 F2d 161, 162 (6th Cir. 1964) that matters of this sort are not "net worth cases," but rather are tax evasion cases. Because of the extremely perilous nature of the type of proof, the Government has an affirmative obligation to reconstruct income with thoroughness. The Handbook for Special Agents (Internal Revenue Manual, Chapter 9900, as of January 29, 1975) recognizes that: "The [gross profit] percentage method is very useful for test checking; for corroborating the results obtained by some other means of proof such as . . . net worth." (§327.11). The Handbook continues: ". . . the percentage method may be a useful method of determining or verifying income, especially when the books and records are inadequate. . ." (§327.13(1)).

Such substantiation to corroborate the inferences generated by the net worth method is not too much to ask of the Government when the perils are so great to the innocent, the information to do so is reasonably available to the Government and the Government will ask the jury to draw those inferences to reach a guilty verdict.

In the instant matter, the Government presented to the jury corporate and personal figures in the hundreds of thousands of dollars without test-checking the implication — without test-checking the very conclusion the jury was asked to reach — that during the indictment years the corporation could have had the excess unreported income to fund the acquisitions alleged. This falls short of the Government's obligation to use net worth methodology with extreme caution and great thoroughness.

A common feeling for human psychology suggests that merely presenting evidence of the corporation's financial size will have a "smoking pistol" effect upon the jury. What else could the jury think but that the corporation was the source of the money?

"There is great danger that the jury may assume that once the Government has established the figures in net worth computations, the crime of tax evasion automatically follows." *Holland, supra*, 348 U.S. at 131.

This danger that figures alone will carry the day looms like the white bear of Lakside; "bare figures have a way of acquiring an existence of their own" which, to borrow a phrase, may dominate a jury "like telling them not to think of a white bear." *Holland, supra*, 348 U.S. at 128, and *Lakside v. U.S.*, 98 S. Ct. 1091, 1098 (1978: dissent), respectively.

Under such conditions, to lead the jury towards reaching a conclusion without attempting to verify the conclusion to which it is being led cannot constitute a good faith discharge of the duty to seek justice rather than a conviction.

As well, then, defense counsel's inquiry as to the "thoroughness" with which the Government ostensibly discharged its duty to reconstruct income should not be narrowly construed as solely an effort to test the efficiency of Costanzo's Bread, Inc. Neither should counsel have been precluded from inquiry into the corroborative effect which the percentage calculations could have been expected to show (or not show) had the Government fulfilled its duty to reconstruct *all* the information relevant to income.

In passing, the paradox should be noted that when the Petitioner claimed the existence of a safety deposit box of cash, the Government "test checked" that box by stuffing it full of federal reserve notes. Yet, they did not "test check" the web of circumstantial figures which they attributed to corporate earnings.

Petitioner contends that to have been denied the right to pursue this meaningful cross-examination was highly prejudicial and deprived him of due process fairness and significant Six Amendment cross examination rights, especially under circumstances when he stood accused of evading both corporate and personal income taxes.

Another example of the deadly impact of uninvestigated inference occurred at trial when the Government introduced evidence that at 9:00 a.m. of the day when IRS agents had scheduled a 10:15 a.m. appointment with petitioner to inventory the contents of his safe deposit box, Mr. Costanzo entered that box. (trial transcript, pp. 1595-1600). Although the IRS investigation actively continued for more than a year thereafter and although IRS agents knew Mr. Costanzo used that box most frequently (some 327 times from 1967-1971), no attempt was ever made to ask Mr. Costanzo why he had gone to that safe deposit box at that particular time. The Government had every opportunity to ask him and did indeed interview him after that date, yet it was never mentioned to him. But the circumstance that he did go was presented to the jury in support of the Government's case without ever having given Mr. Costanzo a chance to explain what may have been a totally innocuous regular-course-of-business incident. For him to have explained at trial would have necessitated sacrifice of his fifth amendment rights and open exposure to cross-examination in general. Yet without explanation, the inference is crippling. Petitioner maintains that the same duty (to seek justice rather than a conviction) which imposes the obligation to investigate taxpayer leads also imposes an obligation on the Government not to lead the jury to inferences which are founded upon incomplete or haphazard investigation.

The petitioner would also ask the Court to consider the admonition in *Holland, supra*, 348 U.S. at 136; that:

"Increases in net worth standing alone, cannot be assumed to be attributable to currently taxable income."

This admonition suggests that, in addition to the dangers inherent in the net worth method's use of circumstantial evidence, there is an equally grave danger that if the circumstantial evidence presented is less than wholly complete, the referent for the tax evaded may not be income but rather an increase in net worth per se. That is, the tax referent may be an increase in assets. Such an asset tax is expressly forbidden by the proscription against direct taxes in the Constitution, Article I, Section 9, Clause 4 (see also *Simmons v. U.S.*, 308 F.2d 160 (CA MD. 1962); *Kohl v. U.S.*, 266 F.2d 381 (CA. Wisc. 1955); *Richardson v. U.S.*, 294 F.2d 593 (CA Mich. 1961) cert. den. 82 S. Ct., 640, 369 U.S. 802, 7 L ed. 2 549.

The presence of this danger becomes all the more real when one recognizes that the principal assumption of the net worth method is that which equates "increases in net worth with unreported taxable income" (*Holland v. U.S.*, supra, 348 U.S. at 131.)

The very real constitutional danger is that the taxpayer may be convicted of tax evasion solely on the strength of an assumption which equates assets and income, an assumption which, standing alone, this Court has held to be inadequate (*Holland, supra*, 348 U.S. at 136.)

The peril to the innocent inherent in a net worth method of circumstantial proof and the danger of direct constitutional conflict if that method of proof is even slightly faulty, combine to require that the Government be held to the highest standards in review of net worth cases.

CONCLUSION

For all these reasons, the Court should grant this petition for certiorari.

Sept., 1978

Respectfully submitted,

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APPENDIX

APPENDIX A

**OPINION OF THE UNITED STATES
COURT OF APPEALS FOR THE
SECOND CIRCUIT**

**UNITED STATES COURT OF APPEALS
For the Second Circuit**

No. 838—September Term, 1977.

(Argued May 5, 1978

Decided July 11, 1978.)

Docket No. 78-1043

United States of America,

Appellee,

—against—

Angelo Costanzo,

Defendant-Appellant.

Before:

Moore, Oakes and Gurfein,

Circuit Judges.

Appeal from a judgment of conviction for income tax evasion entered after a jury trial in the United States District Court for the Western District of New York, Hon. J. T. Curtin, *J.* The Court of Appeals held that the taxpayer's opening net worth was established with sufficient certainty, that proof of a likely source of unreported taxable income was unnecessary because the Government negated all possible sources of nontaxable income, and that the taxpayer's admissions relevant to the existence of a

*Appendix A — Opinion of the United States
Court of Appeals for the Second Circuit*

cash hoard and purchases of stock for his sons were corroborated by the Government's other evidence.

Affirmed.

JOHN W. CONDON, JR., Buffalo, N.Y. (Condon & Sedita, P.C., Buffalo, N.Y., of counsel, Louis A. Haremski, Buffalo, N.Y., on the brief), *for Defendant-Appellant.*

WILLIAM M. SKRETNY, First Assistant United States Attorney, Western District of New York (Richard J. Arcara, United States Attorney, Western District of New York, of counsel), *for Appellee.*

GURFEIN, Circuit Judge:

This is an appeal by Angelo Costanzo from a conviction for income tax evasion. Appellant and his wife were named as defendants in an eight-count indictment covering the years 1968 through 1971. Counts I through IV charged them with evasion of their joint personal income taxes in the amount of \$106,679.93, and Counts V through VIII charged them with the evasion of the corporate income taxes, in the amount of \$114,621.11, of Costanzo's Bread, Inc., a corporation owned by the taxpayers. Appellant was engaged in a bakery business in corporate form, employing forty persons. It sold at wholesale and at retail and included a baked goods counter and a snack bar. The jury acquitted Mrs. Costanzo and returned a verdict of guilty on all counts against appellant.¹ We are asked to reverse the judgment

¹The district court sentenced the taxpayer to imprisonment for one year and one day on each of Counts I though IV, the sentences to run concurrently; the district court imposed a fine of \$10,000 on each of Counts V through VIII, for a total fine of \$40,000.

*Appendix A — Opinion of the United States
Court of Appeals for the Second Circuit*

of conviction and to dismiss the indictment for insufficiency of evidence or to remand for a new trial because of alleged evidentiary errors. We affirm.

We view the evidence in a light most favorable to the Government. *United States v. Brauer*, 482 F.2d 117, 125 (2d Cir. 1973), cert. denied, 419 U.S. 1051 (1974). The Government, employing the "net worth" method of proof, proved the taxpayer's unreported taxable income by showing that the increase in his net worth in the period from 1968 to 1971, plus his nondeductible expenses for those years, exceeded his reported taxable income and his nontaxable receipts. This familiar method of proving tax evasion has been approved by the Supreme Court. *Holland v. United States*, 348 U.S. 121 (1954). But in approving the use of the net worth method, the Court also recognized its potential for mistake and abuse. *Holland, supra*, 348 U.S. at 124-129. Appellate courts have been specifically instructed to "review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation." *Holland, supra*, 348 U.S. at 129. We have accordingly reviewed the record. The taxpayer's principal points on this appeal raise questions about the Government's compliance with the requirements of the net worth method of proof. Though the charge to the jury in such cases is complex, no attack is made upon Judge Curtin's charge.

I

Proof of the Taxpayer's Opening Net Worth

The taxpayer argues that the Government failed adequately to establish his net worth as of December 31, 1967, the opening date of the period. The Supreme Court emphasized the importance of proof of opening net worth in *Holland, supra*, 348 U.S. at 132.

*Appendix A – Opinion of the United States
Court of Appeals for the Second Circuit*

"[A]n essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate further increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset."

The details of the Government's thorough and careful net worth investigation were related to the jury by the Government's witnesses. The Government established an opening net worth of \$450,321.13 as of December 31, 1967. There is no merit in the taxpayer's argument that this opening net worth figure was fatally flawed by a failure to take into account a cache of cash in his or in his wife's safety deposit boxes. While such a defense to a net worth tax evasion case can sometimes destroy the Government's case, see, e.g., *United States v. Bethea*, 537 F.2d 1187, 1189-91 (4th Cir. 1976), the evidence in this case was more than sufficient to negate the existence of such a cash hoard.

The Government examined appellant's income tax returns for the years 1940-1959; the returns showed minimal assets and income insufficient to allow accumulation of a significant cash hoard. See *Holland, supra*, 348 U.S. at 133-34. In addition, the relevant tax returns beginning with 1960, including the tax returns of Costanzo's Bread, Inc., beginning in 1962, were examined. The Government agents computed the appellant's net worth increase for each year from 1960-1971, including a cash assets assumption highly favorable to the taxpayer.² In the period from 1960 to 1971, appellant expended or accumulated

²The taxpayer claimed, during the investigation, that as of 1960 he had kept cash in his safety deposit box, in denominations of bills no higher than \$20. The investigators determined that a box the size of the one rented by the taxpayer would hold 2,450 bills when filled to capacity with new bills, and credited the taxpayer with \$19,000 in cash as of 1960, the beginning date of the net worth calculation.

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\$665,047.13 more than his reported income. Other evidence inconsistent with the cash hoard claim showed that Mrs. Costanzo earned only \$3100 as secretary of the corporation beginning in 1962; that the taxpayer and his wife received no large inheritances or gifts; and that the taxpayer made eight borrowings from 1960, and also borrowed on his insurance policy and had a chattel mortgage on the trade fixtures placed in his business in 1960. In addition, the evidence showed that an inventory of Mrs. Costanzo's safety deposit box during the investigation revealed contents of \$37; no records exist of the contents of the box, or of the taxpayer's deposit box, at earlier times. Although Mrs. Costanzo testified that shortly after 1940 she saw a sizeable cash hoard in a tool box belonging to the taxpayer, the evidence showed that the taxpayer and his wife had had eleven savings accounts and two checking accounts.

The foregoing circumstantial evidence inconsistent with the existence of a cash hoard corroborated the taxpayer's admissions proved by the prosecution. Appellant had stated to investigators that he was "out of cash" as of December 31, 1967, and that he gave his wife only housekeeping money, an admission which negated the possibility that she could have accumulated any substantial amount of money. In view of these admissions, and the Government's corroborating evidence, we think that the evidence was adequate to establish the taxpayer's opening net worth with sufficient certainty.

Appellant contends, at least inferentially, that some of the expenditures made during the taxable period could have derived from the earnings of the bakery business in years preceding 1967. The agents proved the amounts of income reported in the 1960-67 period and properly credited the taxpayer with such amounts. It is true that some of the cash expended after 1967 could have been derived from earlier tax evasion rather than from current income. But it is obvious that this is simply a variation of the "favorite" defense of a cash hoard in existence at

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the beginning of the period covered by the indictment. *Holland, supra*, 348 U.S. at 127. Proof of such cash hoard would have to be tendered by the defendant, or at least given to the Government as a lead for investigation, for it would otherwise be beyond the reach of the Government, *Rossi v. United States*, 289 U.S. 89 (1933). See *United States v. Kiamie*, 258 F.2d 924 (2d Cir.), cert. denied, 358 U.S. 908 (1958). Once the Government had presented its evidence negating the existence of a cash hoard, *supra*, "the defendant remain[ed] quiet at his peril." *Holland, supra*, 348 U.S. at 139. If an earlier tax evasion is the defense, it is the defendant who must prove it; otherwise the court and the jury may presume that the defendant acted in accordance with the law in his earlier dealings with the Government.

In fact, the appellant tried to introduce the reports of the revenue agents who audited Costanzo's Bread, Inc. in 1963 and 1969, with findings that only small changes from the income tax returns were required. If the reports, tendered by the defendant as a true reflection of his affairs, had been allowed into evidence, the 1963 report would have tended to show that the expenditures in the taxable period proved by the Government did *not* have as their source unreported income during the period preceding the taxable period.

Appellant argues, nevertheless, that it was error to exclude the agent's reports. Such reports generally have an internal verity which keeps them from necessarily being objectionable hearsay. Fed. R. Evid. 803(8) (C).³ Though the reports were not hearsay,

³Fed. R. Evid. 803(8)(C) provides:

"The following are not excluded by the hearsay rule, even though the declarant is available as a witness:

"(8) Public records and reports. Records, reports, statements, or data compilations in any form, of public offices or agencies, setting forth . . . (C) in civil actions and proceedings and against the Government in criminal cases, factual findings resulting from an investigation made pursuant to authority granted by law, unless the sources of information or other circumstances indicate lack of trustworthiness."

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however, they were not relevant to the issues in this tax evasion prosecution. The reports show only a correspondence between the corporation's records and the returns that it filed, while the Government's case turned on convincing the jury that the corporation's records did not reflect the true receipts of the business. There was no error in this exclusion of irrelevant evidence. In any event, the substance of the reports was elicited upon cross-examination of the agents, and the reports themselves were cumulative evidence which the trial judge could exclude in his discretion.

II

Proof of a Likely Source of Unreported Taxable Income.

In *Holland, supra*, the Supreme Court indicated that in addition to proving an increase in the taxpayer's net worth, the Government was required in that case to prove a likely source of unreported taxable income. 348 U.S. at 137-38. But the Government is not required to prove a likely source of unreported taxable income in every net worth case; rather, it may either prove a likely source of taxable income or negate any possible source of nontaxable income.

"In *Holland* we held that proof of a likely source was 'sufficient' to convict in a net worth case where the Government did not negative all the possible nontaxable sources of the alleged net worth increase. This was not intended to imply that proof of a likely source was necessary in every case. On the contrary, should all possible sources of nontaxable income be negated, there would be no necessity for proof of a likely source."

United States v. Massei, 355 U.S. 595, 595 (1958) (*per curiam*).

The taxpayer in the present case claimed that the increase in his net worth was only apparent, and in fact resulted from the investment of a pre-existing cash hoard. But the evidence offered

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by the Government was sufficient to negate the existence of such a hoard, as we have already noted, *supra*. The Government also introduced evidence to negate the receipt of gifts or inheritances by the taxpayer or his wife during the period covered by the indictment. The Government's proof thus went beyond the single source of nontaxable income (the cash hoard) suggested by the taxpayer, and was more than sufficient to negate the receipt of nontaxable income by the taxpayer. See *United States v. Bianco*, 534 F.2d 501, 506 (2d Cir.), cert. denied, 429 U.S. 822 (1976); *Gatling v. Commissioner*, 286 F.2d 139, 144 (4th Cir. 1961). Having negated all possible sources of nontaxable income, the Government was not required to prove a likely source of taxable income. *Massei, supra*; *United States v. Schipani*, 414 F.2d 1262, 1264-65, 1267 (2d Cir. 1969), cert. denied, 397 U.S. 922 (1970). See also *United States v. Ford*, 237 F.2d 57, 63 (2d Cir. 1956); *United States v. Mitchell*, 413 F.2d 181 (7th Cir. 1969). As the Ninth Circuit noted in *Whitfield v. United States*, 383 F.2d 142, 144 (1967):

"If . . . the prosecution was compelled to relate all the unreported income precisely to the motel operation, then employment of the 'net worth' method of proof would have been unnecessary."

The Government, in any event, offered extensive proof that the taxpayer's business was a likely source of unreported taxable income. The evidence showed that Costanzo's Bread, Inc., was a successful business with many sizeable accounts, and was large enough to generate substantial amounts of unreported cash receipts. The corporation *reported* nearly half a million dollars in gross sales in each of the four years in question. The evidence also showed that large amounts of cash were received, that cash receipts were recorded by the taxpayer or his wife, and that the receipts and cash register tapes from which the records were prepared were subsequently destroyed. The taxpayer himself

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made all of the deposits to the corporate bank account. We see no merit in the taxpayer's argument that the Government failed to prove that the business was a likely source because it did not prove either the physical production capacity of the bakery or the gross profit percentage of similar businesses in upstate New York.⁴ The mistaken assumption underlying this argument is that the Government must show that the bakery was capable of generating the entire amount of the unreported income alleged in the indictment. As we have noted, such proof is unnecessary in this net worth case. The Government's evidence showed, in any event, that the bakery was a likely source of at least a substantial portion of the unreported income charged in the indictment.⁵

⁴Gross profit percentage is the ratio of gross profits to gross receipts. Given the cost of materials purchased by Costanzo's Bread and the gross profit percentage for bakeries of like size and activity in the region, one conceivably could calculate the gross profit that could be generated by the use of the materials purchased by Costanzo's Bread, although the cost of materials in a bakery business might have very little relationship to the profit ratio. The defense offered no proof of either the prevailing gross profit percentage in the bakery business in the region or the physical production capacity of the bakery. There was also affirmative evidence of the receipt of cash as well as the payment of expenses in cash.

⁵It would have been necessary to underreport the gross receipts of Costanzo's Bread by only 8 to 18 percent for the four years in question to generate the entire amount of unreported income charged in the indictment.

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III

The Government's Investigation.

The circumstantial nature of the proof relied upon in a net worth tax evasion case led the Supreme Court to indicate that the sufficiency of the evidence to support a conviction should be measured in light of the thoroughness of the Government's investigation of all relevant circumstances.⁶ The thoroughness of the Government's investigation of the cash hoard claim has already been reviewed in connection with the opening net worth calculation, *supra*. The Government's investigation covered every circumstance that might have shed light on the creation or existence of a cash hoard, and the evidence of this investigation was sufficient to negate the claim of a cash hoard on hand as of December 31, 1967, sufficient in amount to account for the expenditures.

The Government's investigation of the purchases of stock in the names of the taxpayer's sons was also sufficient to meet the standards laid down in *Holland*. Some of the stock purchases

6 "It is, of course, not for us to prescribe investigative procedures, but it is within the province of the courts to pass upon the sufficiency of the evidence to convict. When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer — leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence. When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury."

Holland, supra, 348 U.S. at 135-36 (footnote omitted).

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relied upon by the Government to show the increase in the taxpayer's net worth were made in the names of the taxpayer's sons. The taxpayer admitted to the agents that he had paid for the stock purchases in his sons' accounts. The Government's investigation corroborated this admission by producing evidence from the taxpayer's broker that the taxpayer placed buy orders for his sons' accounts as well as statements by the taxpayers' sons that he had indeed paid for the stock purchased in their names. The Government's proof also showed that Angelo Costanzo, Jr., had an average reported gross annual income of \$11,670 in 1965-1971, and that Richard Costanzo, the other son, had an average reported gross annual income of \$8,045 in 1965-1971. The purchases in their names amounted to \$313,070 for those years. Finally, the Government was able in many instances to show that purchases for the sons' accounts had been paid for by checks from the taxpayer. The evidence produced by this thorough investigation was sufficient to corroborate the appellant's admission that he had bought *all* of the stock in his sons' names.⁷

7The defendant claimed that \$250 that he received during the relevant period was the repayment of a loan that he had made earlier to Jerome Walters, and that the Government's investigation of the loan transaction was inadequate. The Government failed to locate Walters, or to ask the defendant's aid in finding him. But the Government's failure to locate Walters or to seek the defendant's help in doing so was brought out fully on cross-examination. Further, the availability to the taxpayer of \$250 from a nontaxable source is inconsequential in view of the size of the unexplained increase in net worth proved by the Government. In this criminal prosecution, the Government was required to show only that the taxpayer had willfully evaded payment of taxes and not the exact amount of the income that went unreported or the taxes that went unpaid. See *United States v. Parr*, 509 F.2d 1381, 1385-86 (5th Cir. 1975).

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IV.

Evidentiary Rulings at Trial.

The taxpayer argues that the trial court committed prejudicial error in its rulings on certain evidentiary questions. He urges, first, that it was error to allow a Government witness to testify about the statements by the taxpayer's sons that their stock had been purchased by the taxpayer. These statements were made in the taxpayer's presence, and he concurred in them at the time. Since the statements were offered against the taxpayer, they were admissible under Fed. R. Evid. 801(d)(2)(B). Further, since the taxpayer's own unequivocal admission that he had purchased the stock in his sons' names was properly received into evidence, and sufficiently corroborated, the admission of the sons's statements cannot have been prejudicial.

In cross-examining the Government's witnesses defense counsel was allowed to establish that the Government had not used the gross profit percentage calculation during its investigation, and that it had not determined the physical production capacity of the bakery. Additional cross-examination on these two points was not allowed by the trial court, but this line of inquiry went beyond the subjects of the direct examination and was within the court's discretion to exclude. Fed. R. Evid. 611(b). Further, neither cross-examination nor direct evidence on these two points could have aided the taxpayer. Given the Government's proof of unreported income and its negation of all possible sources of nontaxable income, proof of a likely source of taxable income was not necessary, as we have seen. Appellant made no offer to prove through his own witnesses the lack of capacity of the bakery to generate income beyond that reported.

Affirmed.

APPENDIX B

FOURTEENTH AMENDMENT

AMENDMENT XIV. — CITIZENSHIP; PRIVILEGES AND IMMUNITIES; DUE PROCESS; EQUAL PROTECTION; APPORTIONMENT OF REPRESENTATION; DISQUALIFICATION OF OFFICERS; PUBLIC DEBT; ENFORCEMENT.

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Section 2. Representatives shall be apportioned among the several States according to their respective numbers, counting the whole number of persons in each State, excluding Indians not taxed. But when the right to vote at any election for the choice of electors for President and Vice President of the United States, Representatives in Congress, the Executive and Judicial officers of a State, or the members of the Legislature thereof, is denied to any of the male inhabitants of such State, being twenty-one years of age, and citizens of the United States, or in any way abridged, except for participation in rebellion, or other crime, the basis of representation therein shall be reduced in the proportion which the number of such male citizens shall bear to the whole number of male citizens twenty-one years of age in such State.

Section 3. No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the United States, or under any

Appendix B – Fourteenth Amendment

State, who, having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any State legislature, or as an executive or judicial officer of any State, to support the Constitution of the United States, shall have engaged in insurrection or rebellion against the same, or given aid or comfort to the enemies thereof. But Congress may by a vote of two-thirds of each House, remove such disability.

Section 4. The validity of the public debt of the United States, authorized by law, including debts incurred for payments of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

Section 5. The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.